

STATEMENT OF

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PRESENTED TO THE

**FEDERAL TRADE COMMISSION
&
DEPARTMENT OF JUSTICE**

IN HEARINGS ON

**COMPETITION & INTELLECTUAL PROPERTY LAW
AND POLICY IN THE KNOWLEDGE-BASED ECONOMY**

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Mr. Chairman, members of the Federal Trade Commission and Officials of Department of Justice:

Thank you for the opportunity to testify during these important hearings. Examining the interface between patent law and antitrust law is always a worthwhile exercise, and it is particularly important when we perceive basic changes in our economy and our technology, as we do now with the increasing importance of information technology.

My name is Charles Baker. I am a partner in New York City office of the intellectual property law firm, Fitzpatrick, Cella, Harper & Scinto. In addition, I am Chair of the Section of Intellectual Property Law of the American Bar Association. The Section has 21,000 members and contributes in significant ways to the development of intellectual property law in the United States and in the world. In addition to providing information to the Executive Branch of the US government, as Mr. Taylor is doing here today on behalf of the Section, our members and committees study US and international IP laws, and the Section provides its comments in the form of Congressional testimony, *amicus* briefs, attendance at conferences that draft international treaties, and in many other ways.

Many of the submissions by the IP Law Section relate to the interface between IP and antitrust law. To cite two recent examples, I testified on behalf of the Section in October, 2001 before the Committee on the Judiciary of the U.S.

House in favor of legislation that would prohibit market power presumptions based on intellectual property in antitrust actions, and in April of this year the IP Law Section joined with the ABA's Antitrust Section and its International Law Section to provide comments to the European Community Commission's Report concerning block exemptions in its regulations on technology transfers.

I am here today, however, in my personal capacity. The views expressed are my own -- not those of my firm or the IP Law Section or the ABA.

This morning I want to focus on three subjects:

1. By way of background relative to the subject of these hearings, I want to touch briefly on whether competition and IP law should differ in a knowledge-based economy from what they are in any other economy. Based on my personal experience with large and small patent owners over many years, it seems to me that the most important purpose of these laws, both IP and antitrust, is to encourage investors to invest in new technologies, even though they could choose to invest in real estate or in established businesses. Therefore, I see no reason that IP or antitrust law should be different in a knowledge-based economy.

2. Then I will address the topic of this panel -- the Jurisdiction of the Court of Appeals for the Federal Circuit. We all know that Congress created the Federal Circuit to promote uniformity in the patent law. It is also plain that

Congress intended this uniformity to extend to the interface between patent law and antitrust law. In this context I will discuss the recent Supreme Court decision in *Holmes v. Vornado*, decided June 3, 2002. While not an antitrust law case, it suggests that some cases that in the past might have gone to the Court of Appeals for the Federal Circuit will now go to the regional circuits. There are questions about whether this opportunity for deviation from uniformity is desirable or consistent with Congressional intent.

3. Finally, I would like to review the jurisprudence the Federal Circuit has developed with respect to competition law. It seems to me the Federal Circuit has comported with Congressional intent in bringing about uniformity in the mainstream of current law at the patent/antitrust interface.

Encouraging Investment and Promoting Competition in a Knowledge-Based Economy

The reasons that argue for exclusive rights in inventions and creative works are the same in a knowledge-based economy as they are in any other. The exclusive rights created by the patent law, copyright law and trademark law make it easier to transfer technology or rights in other creative works through assignment and license. As a consequence, investors are encouraged to invest in

them, rather than in something like real estate, and new jobs are created in new industries. Also, technologies and other IP rights tend to move into the hands of those who can best develop and use them to compete effectively. The principal alternative to patents - - trade secrets - - would reduce the incentives for disclosure and transfer, resulting in less use of innovations, and less building on one invention to create further inventive benefits.

Also, a system built mainly on trade secrets would likely favor big businesses, which would be more able to maintain their markets through sheer size. Small and new firms, however, would find it difficult in a trade-secret-only system to obtain a competitive advantage by innovating because larger firms have more resources to reverse engineer and imitate technology. The existence of exclusive rights in inventions is essential for small, new firms to compete against large, entrenched firms.

The exclusivity arising from the patent grant, like the exclusivity arising from the ownership of prime real property, may enable the owner to charge a higher price. In the case of the patent grant, however, the period of exclusivity is limited, and that limited exclusivity results solely from the patentee's disclosure to the public, which informs even his competitors about what he is doing. The exclusivity is also limited in practice because usually the scope of patent claims do

not cover all relevant products in a market. As a practical matter, alternatives and reasonably interchangeable substitutes almost always exists.

In preparation for these hearings some people have suggested there are “tensions” between “antitrust and IP doctrines” and questioned whether “the right balance” has been achieved in particular areas of the interface between the two. The patent policy contemplated by the framers of the Constitution unquestionably promotes and aids competition, and there is no need to “balance” any “tensions” between IP law and patent law as properly perceived. The creation of property rights in inventions encourages investment in the development of new competitive technologies. Without those rights, there would be less competition.

At one time there was a view that a conflict existed between the intellectual property laws, which were said to grant a “monopoly” to the intellectual property owner, and the antitrust laws, which were said to prevent the creation or enhancement of monopoly power.^{1/} The prevailing view today, however, is that the IP laws confer property rights in the form of exclusive rights over technology or other creative works. These may or may not give rise to monopoly power. A

^{1/} See *SCM Corp. v. Xerox Corp.*, 645 F.2d 1195, 1203 (2d Cir. 1981), *cert. denied*, 455 U.S. 1016 (1982) (“[T]he patent and antitrust laws necessarily clash. . . . [T]he primary purpose of the antitrust laws -- to preserve competition -- can be frustrated, albeit temporarily, by a holder’s exercise of the patent’s inherent exclusionary power during its term.”).

particular patent may offer one of several competing technological solutions and confer no market power on its owner, or it may offer the only solution and give its owner significant market power.

Thus, intellectual property law and antitrust law are consistent because they have the same ultimate objectives of promoting economic progress and consumer welfare. As explained in one leading case,^{2/}

“[W]hen [a] patented product is so successful that it creates its own economic market or consumes a large section of an existing market, the aims and objectives of patent and antitrust laws may seem, at first glance, wholly at odds. However, the two bodies of law are actually complementary, as both are aimed at encouraging innovation, industry and competition.”

Another of the “general issues” for these hearings relates to the roles of “competition law” and patent law in “fostering initial and follow-on innovation.” It seems to me that patent rights should be treated the same under competition law regardless of the timing or break-through nature of an invention.

First, Congress created no second class utility patent. The importance of any patent is already built into it by the patent examining process. Its breadth is determined by the content of its disclosure and the degree to which that disclosure

^{2/} *Atari Games Corp. v. Nintendo of America, Inc.*, 897 F.2d 1572, 1576 (Fed. Cir. 1990), citing *Loctite Corp. v. Ultraseal Ltd.*, 781 F.2d 861, 876-77 (Fed. Cir. 1985).

represents an improvement over the prior art. To the extent some difference exists between “initial” and “follow-on” patents, that difference will be reflected in the scope of the claims that will issue.

Second, who is to say where “initial” innovation ends and “follow-on” innovation begins? These are differences that theoreticians may like to talk about, but they have little relevance to the real world. There are many examples of a seemingly small innovation, created late in a development project, that makes everything that went before it practical.

Third, casting doubt on the quality of exclusive rights would create confusion and destroy the value of those rights. Should the person who owns real property in the middle of a town that is 100 years old have different or lesser rights from the owner of property in the middle of a new town? The properties may have different values, but they are the same kind of property.

Another “general issue” on the agenda for these hearings is “what should be the standards for assessing the anti-trust significance of a unilateral refusal to deal.” At present Congress has made no qualification on the right of an owner of intellectual property to refuse to use or sell something within the scope of its issued claims. Indeed, Section 271(d)(4) of the Patent Code explicitly reaffirms that right.

Another issue presented for the hearings is whether the standard for patentability is too low. The main reason given for this concern is the greatly increasing number of patents being issued. The numbers are going up, however, not because the standard for patentability is too low, but because more money is being spent on research. For example, as former Commissioner Gerry Mossinghoff pointed out in his February 6, 2002 statement in these hearings, R&D expenditures in the pharmaceutical industry have increased more than ten-fold in the last twenty years, but the number of patents issued has risen at only 1/3 that rate. His numbers were \$2.3 billion for R&D in 1981 (2,017 patents), and \$30 billion in 2001 (6,751 patents). Hence, there is no reason to “raise the bar” for patent issuance. More than that, the patentability standard -- “non-obviousness” -- has stood the test of time. Written into the law fifty years ago as a codification of the main body of moderate case law at the time, in the last 20 years it has had the benefit of uniform interpretation by the Court of Appeals for the Federal Circuit. This extensive use argues that we have the correct standard. Even if it were not the very best standard, change would create uncertainty and confusion.

Another issue is whether the subject matter of patents should be limited (*e.g.*, whether business methods should be excluded). There are several reasons to refuse to treat different areas of invention differently. First, and again as a

practical matter, there would be substantial problems in deciding where to draw the line between patentable and unpatentable technology. For example, certain methods of doing business might be stated in terms of performing research steps; or the patent claims might include nearly trivial tangible items, like an order form, to remove the patent from the category of business methods. More to the substance, if a method of doing business is novel and non-obvious, should we not as a country want to encourage investment to develop it and make its benefits available to all of us? The issuance of a couple of high-profile, potentially overly broad business method patents should not cause us to miss the benefits of proper patents.

Some submissions in these hearings by theoretical economists show a general failure to appreciate the real world. An example is the concern of some over so-called “blocking patents.” In the real world, these seldom arise. It is true that when a pioneer invention is made, no one else but the inventor can use it. At that stage, however, much development remains to be done, there is still competition from the old technology, and the costs of development are high, so few if any are interested in the unproven invention. For example, when Chester Carlson discovered xerography, he had a hard time finding anyone to invest in it.

After a technology has developed, blocking patents also seldom occur because there are ways to work around the narrow patents of a mature technology.

Uniform Appellate Review for Patent Matters

Turning to specific topic of today's panel, with the support of both the Carter and then the Reagan administrations, Congress created the Court of Appeals for the Federal Circuit to be (i) a centralized national court whose jurisdiction would include exclusive appellate jurisdiction over patent-related cases; and (ii) a "vehicle for ensuring a more uniform interpretation of the patent laws, thus contributing meaningfully and positively to predicting the strength of patents."^{3/} As Gerry Mossinghoff points out in his February 6, 2002 statement, quoting successful businessman and Secretary of Commerce Malcolm Baldrige, businessmen can deal with adversity, but they cannot handle uncertainty.

^{3/} Hearings on H.R. 6033, H.R. 6934, H.R. 3806 and H.R. 2414 before the Subcommittee on Courts, Civil Liberties and Administration of Justice, House Committee on the Judiciary, page 797, 96th Cong., 2d Sess. (1980).

Jurisdiction Over Matters of the Patent/Antitrust Law Interface

In order to achieve uniformity in patent law, Federal Circuit jurisdiction is subject-based, rather than geography-based. Section 1295(a)(1) provides that the Federal Circuit has jurisdiction over cases in which the district court's jurisdiction was based in "whole or in part" on the patent laws of the United States.^{4/} The statute thus grants the Federal Circuit jurisdiction over many non-patent issues, as long as part of the original district court jurisdiction was based in patent law. The House Report envisioned that the Federal Circuit may hear a variety of issues including "misuse, fraud, inequitable conduct, **violations of the antitrust laws**, breach of trade secret agreements, unfair competition, and such common law claims as unjust enrichment."^{5/} Similarly, the Senate Report assuaged the critics of specialized courts by stating that the Federal Circuit judges "will have no lack of exposure to a broad variety of legal problems" and that "the subject matter of the new court will be sufficiently mixed to prevent any special interest from dominating it."^{6/}

^{4/} See H.R. Rep. No. 97-312, at 23-24 (1981).

^{5/} *Id.* (emphasis added).

^{6/} S. Rep. No. 97-275, at 6 (1981).

On the other hand, Congress did not want the assertion of specious patent claims in the lower court to create jurisdiction in the Federal Circuit. “If, for example, a patent claim is manipulatively joined to an antitrust action but severed or dismissed before final decision of the antitrust claim, jurisdiction over the appeal should not be changed by this Act but should rest with the regional court of appeals.”^{7/}

As the Senate Report makes plain, when a substantial patent claim and a related antitrust claim appear in the same case, the appeal should go to the Federal Circuit:

Allegations of patent-misuse type of antitrust violations do not change the nature of the case from one in which jurisdiction was based on section 1338 of title 28. . . . As indicated, the issues raised are patent issues merely couched in antitrust terms. No difficulty would occur in the appeal of those cases to the Court of Appeals for the Federal Circuit. Indeed, maximum achievement of a major goal of the bill, the provision of reliability and uniformity in the rules to be applied in patent cases, would require direction of the appeal in those cases to the Court of Appeals for the Federal Circuit.^{8/}

^{7/} *Id.*

^{8/} *Id.* at 37-38 (Letter of Oct. 19, 1981, from William James Weller, Leg. Affairs Officer).

Thus, Congress's intent seems clear: at least when the antitrust claims are of the "patent misuse" variety or otherwise present a patent policy issue that would benefit from uniformity, the Federal Circuit should have appellate jurisdiction.

Uncertainties Created by *Holmes v. Vornado*

The recent Supreme Court case *Holmes v. Vornado*, 122 S.Ct. 1889 (2002), however, has apparently narrowed the Federal Circuit's jurisdiction, though the extent of the narrowing is not yet clear. In that case the Supreme Court held that the Federal Circuit lacked jurisdiction over an appeal when the complaint raised no claim arising under the patent laws, but the answer included a compulsory patent law counterclaim. According to Chief Judge H. Robert Mayer of the Federal Circuit, as reported in the National Law Journal, *Holmes* is likely to limit the availability of Federal Court review and permit forum shopping, and both results may return the state of patent law to that existing before the Federal Circuit's creation, a situation in which diversity in the application of the patent laws reduced the value of patents.^{2/} This decision may be a particular concern to

^{2/} Anne M. Maher, "The Holmes Decision," The National Law Journal, July 8, 2002, which discusses of *Holmes* and its implications. Ms. Maher suggests that the Supreme Court, having admonished the Federal Circuit for upsetting expectations in its *Festo* decision (see 122 S.Ct. 1831 (2002)), may itself have effected in *Holmes* a more "seismic" change in patent law.

litigants in cases involving patent as well as antitrust issues. For example, in *In re Innotron Diagnostics*, 800 F.2d 1077, 1080 (Fed. Cir. 1986), the Court consolidated an antitrust suit with a patent infringement action. The Federal Circuit retained appellate jurisdiction in that case, but after *Holmes* the result might likely be different. As a recent example, on July 2, 2002 the Federal Circuit transferred to the Eleventh Circuit an appeal filed in 2000 because jurisdiction in the Federal Circuit was predicated on a patent infringement counterclaim.^{10/}

From this it follows that *Holmes* may introduce conflicts in substantive law at the patent/antitrust interface that the public thought the Federal Circuit had settled. Post-*Holmes*, the regional circuits may decide to apply Federal Circuit patent/antitrust law precedent to their cases, or they may decide to rely on their own circuits' pre-1982 patent law precedent in view of any Supreme Court precedent since 1982. If a regional circuit follows its own precedent, law at the patent/antitrust interface may vary between the circuits, creating unpredictability and forum shopping, which would be contrary to Congress's major objective in creating the Federal Circuit.

^{10/} *Telcomm Technical Services v. Siemens Rolm Communications, Inc.* (Fed. Cir. July 2, 2002), a case based on refusal to deal in goods protected by trade secrets.

The impact of *Holmes* may be moderated, however, by the passage in *Holmes* (page 4 of the slip opinion) where Justice Scalia quotes from *Christianson v. Colt Industries Operating Corp.*^{11/} for the proposition that the Federal Circuit may have jurisdiction, even though the plaintiff's claim is not created by patent law, if plaintiff's right to relief necessarily depends on a substantial question of patent law. Justice Scalia said,

“The plaintiff's well pleaded complaint must ‘establish either that federal patent law creates the cause of action or that the plaintiff's right to relief necessarily depends on resolution of a substantial question of federal patent law’”^{12/}

Choice of Law at the Interface and Competition Policy Perspectives in the Federal Circuit

On antitrust issues, where the Federal Circuit perceives a patent policy issue that would benefit from uniformity, it follows its own precedent, but otherwise it will follow precedent of the circuit court of appeals for the region for the trial court in the particular case,^{13/}

^{11/} 486 U.S. 800, 809 (1988).

^{12/} Query whether the result in *Telcomm, supra*, would have been different if the refusal to deal were based on goods protected by patents.

^{13/} See *Nobelpharma AB v. Implant Innovations*, 141 F.3d 1059, 1067-68 (Fed. Cir. 1998), also *cf. In re Independent Service Organizations Antitrust Litigation*, 203 F.3d 1322, 1325 (2000) (treatment of patent issues and copyrights issues).

In those situations where the Federal Circuit has applied its own antitrust law -- that is, where it intersects with the patent law -- the Court has done so relatively consistently and within the mainstream of current antitrust analysis. Its different panels almost universally have pushed the envelope in the same direction, apparently based upon recognition that the Court's primary mission is to provide uniformity and predictability in the application of patent law.

For example, in the Federal Circuit the analysis employed for finding misuse of a patent look to the economic effect of patentees' use of their patents. This began in *Windsurfing*^{14/} with Chief Judge Markey's endorsement of Judge Posner's economic reasoning in *USM Corp. v. SPS Technols., Inc.*, 694 F.2d 505, 510-14 (7th Cir. 1982).^{15/}

As another example, in *In re Independent Service Organizations Antitrust Litigation*,^{16/} the Federal Circuit found support for the patentee's right to exclude with impunity in Congressional enactment of Section 271(d)(4) of the Patent

^{14/} *Windsurfing Int'l Inc. v. AMF Inc.*, 828 F.2d 755 (1987).

^{15/} Judge Posner's recent decision in *Scheiber v. Dolby Laboratories, Inc.*, 2002 U.S. App. LEXIS 11878 (7th Cir., June 17, 2002), questions *Brulotte v. Thys Co.*, 379 U.S. 29 (1964), on modern economic reasoning. Query whether this will lead the Supreme Court to bring that decision up-to-date.

^{16/} 203 F.2d 1322 (Fed. Cir. 2000), cited with approval in *Schering-Plough Corp. v. Upsher-Smith* (FTC, June 27, 2002) (Chappell, A.L.J.), slip. op. at 104.

Code. The Federal Circuit arguably concluded that, to the extent Section 271(d)(4) defines conduct that cannot support unenforceability, that determination should preclude any attempt to ground an antitrust violation upon the same conduct.

In *Nobelpharma*,^{17/} the Federal Circuit applied its own law to settle authoritatively that a Sherman Act Section 2 violation can be predicted upon omissions as well as upon affirmative misrepresentations made to the PTO. This relatively narrow and not unexpected ruling is in many ways typical of the Court's handling of *Walker Process*^{18/} and *Handgards*^{19/} determinations that are an adjunct to its steady diet of infringement litigation. That case load requires frequent and careful application of the Supreme Court's *PRE*^{20/} standard.

^{17/} 141 F.3d 1059 (Fed. Cir. 1998).

^{18/} *Walker Process Equipment, Inc. v. Food Machinery & Chemical Corp.*, 382 U.S. 172 (1965).

^{19/} *Handgards, Inc. v. Ethicon, Inc.*, 601 F.2d 986 (9th Cir. 1979) (Handgards I); *Handgards, Inc. v. Ethicon, Inc.*, 743 F.2d 1282 (9th Cir. 1984) (Handgards II).

^{20/} *Professional Real Estate Investors, Inc. v. Columbia Pictures Indus.*, 508 U.S. 49 (1993).

The Federal Circuit has also rejected a market power presumption for intellectual property in the antitrust context,^{21/} joining with several regional circuits and two federal antitrust enforcement agencies -- the U.S. Department of Justice Antitrust Division and the Federal Trade Commission -- which have rejected the presumption. The Guidelines for the Licensing of Intellectual Property provide:

The Agencies will not presume that a patent, copyright, or trade secret necessarily confers market power upon its owner. Although the intellectual property right confers the power to exclude with respect to the specific product, process, or work in question, there will often be sufficient actual or potential close substitutes for such product, process, or work to prevent the exercise of market power.^{22/}

As the analysis in *In re Independent Service Organizations* makes clear, as long as a patent owner does not exercise power beyond the scope of the patent coverage (for example, by tie-ins, by extensions in time or by price fixing in licenses), the owner may dominate the market covered by the patent, even if that is a relevant product market for antitrust purposes. By the grant of market

^{21/} *In re Independent Service Organizations*, 203 F.3d 1322, 1325 (2000); *Abbott Labs. v. Brennan*, 952 F.2d 1346, 1354 (Fed. Cir. 1991), *cert. denied*, 505 U.S. 1205 (1992).

^{22/} Antitrust Guidelines for the Licensing of Intellectual Property issued by the U.S. Department of Justice and Federal Trade Commission § 2.2, 1995 WL 229332 (April 6, 1995).

exclusivity to the patent owner, the public obtains disclosure of the patent owner's improvements and encourages investment in developing that improvement to make it available to the public. Only when the patent owner seeks to exercise that power beyond the patent coverage does the owner run afoul of the antitrust laws. As the Federal Circuit explained, a patent holder has the "right" to refuse to sell or license in markets within the scope of the statutory patent grant.

"Xerox's refusal to sell its patent parts [does not exceed] the scope of the patent grant Therefore, our inquiry is at an end. Xerox was under no obligation to sell or license its patent parts and did not violate the antitrust laws by refusing to do so." 203 F.3d at 1328.

In sum, one seeking a predictable result in these areas will consider ensuring that the appeal can be taken to the Federal Circuit.